

Initial Statement of Reasons for
Proposed Amendments to California Code of Regulations, Title 18,
Section 1685.5, *Calculation of Estimated Use Tax - Use Tax Table*

SPECIFIC PURPOSE AND NECESSITY

Current Law

Under Revenue and Taxation Code (RTC) sections 6202 and 6453, consumers are primarily liable for reporting and paying use tax imposed on the storage, use, or other consumption of tangible personal property in this state. However, under RTC sections 6203, 6226, and 6453, specified retailers are required to register with the State Board of Equalization (Board), collect use tax from their California customers, and report and pay the use tax to the state. Therefore, under California Code of Regulations, title 18, section (Regulation) 1685, *Payment of Tax by Purchasers*, consumers are required to report and pay their own use taxes to the state when they purchase tangible personal property for storage, use, or other consumption in this state from unregistered retailers that do not collect California use tax.

Prior to 2010, consumers could only report and pay their use taxes to the Board. However, RTC section 6452.1 was enacted in 2010 to make it more convenient for consumers to comply with their use tax obligations by permitting consumers to make an irrevocable election to report “qualified use tax” on an “acceptable [income] tax return” filed with the Franchise Tax Board (FTB). RTC section 6452.1, subdivision (d)(2), as enacted by Statutes 2010, chapter 721, defined the term “qualified use tax” to mean a taxpayer’s actual unpaid use tax liability after applying the state use taxes imposed under the Sales and Use Tax Law (RTC § 6001 et seq.) and section 35 of article XIII of the California Constitution, and the local and district use taxes imposed in conformity with the Bradley-Burns Uniform Local Sales and Use Tax Law (RTC § 7200 et seq.) or in accordance with the Transactions and Use Tax Law (RTC § 7251 et seq.) to the taxpayer’s purchases of tangible personal property subject to use tax.

Senate Bill No. (SB) 86 (Stats. 2011, ch. 14) amended RTC section 6452.1 to make it more convenient for taxpayers to comply with their use tax obligations by giving taxpayers the option to report their “estimated use tax liabilities,” based upon their adjusted gross incomes (AGIs) for income tax purposes, for one or more single nonbusiness purchases of individual items of tangible personal property each with a sales price of less than one thousand dollars (\$1000), as determined from a use tax table, on their income tax returns, instead of calculating and reporting their actual unpaid use tax liabilities (as described above). In addition, RTC section 6452.1, subdivision (d)(2)(A)(i)(II), as amended by SB 86, requires the Board to “annually calculate the estimated amount of use tax due according to a person’s adjusted gross income and by July 30 of each calendar year make available to [the] Franchise Tax Board such amounts in the form of a use tax table” for inclusion in the instructions to the FTB’s returns and

use by eligible taxpayers. Furthermore, SB 86 expanded the definition of “qualified use tax” by deleting the reference to “section 35” of article XIII of the California Constitution from RTC section 6452.1, subdivision (d)(2).

The Board adopted Regulation 1685.5, *Calculation of Estimated Use Tax - Use Tax Table*, on July 26, 2011, to prescribe the specific use tax table that taxpayers could use to estimate their calendar-year 2011 use taxes based upon their AGIs, prescribe the manner in which the Board shall annually calculate the estimated amount of use tax due according to a person’s AGI for calendar-year 2012 and subsequent years, and prescribe the format of the use tax tables the Board would be required to make available to the FTB for calendar-year 2012 and subsequent years.

As relevant here, Regulation 1685.5, subdivision (b)(7), defines the “average state, local, and district sales and use tax rate” for purposes of determining the rate of sales and use tax to be used to calculate the estimated amount of use tax due according to a person’s AGI. And, subdivision (b)(7)(A) of Regulation 1685.5 specifically includes the rate of the taxes imposed by “section 35 of article XIII of the California Constitution” in the average state, local, and district sales and use tax rate because the only statewide sales and use taxes imposed under the California Constitution at the time Regulation 1685.5 was adopted were the taxes imposed by section 35 of article XIII.

Specific Purpose, Necessity, and Benefits of the Proposed Amendments

California voters approved Proposition 30 in the General Election of 2012, and Proposition 30 added section 36 to article XIII of the California Constitution to impose temporary sales and use taxes, and temporarily increase the statewide sales and use tax rate by one quarter of one percent on and after January 1, 2013, and before January 1, 2017. Therefore, Board staff determined that there was an issue (or problem within the meaning of Gov. Code, § 11346.2, subdivision (b)(1)) because the definition of the average state, local, and district sales and use tax rate in Regulation 1685.5, subdivision (b)(7), does not include the rate of the temporary taxes, which must be included in the Board’s calculations of the estimated amount of use tax due according to a person’s AGI for 2013 through 2016 to ensure that the Board’s calculations are consistent with the provisions of the California Constitution and the statutory definition of “qualified use tax.” And, Board staff concluded that the definition of the average state, local, and district tax rate in Regulation 1685.5, subdivision (b)(7), needs to be amended to include the rate of the temporary taxes in order to address the issue.

As a result, Board staff prepared Formal Issue Paper 14-008, which recommended that the Board make Regulation 1685.5’s definition of the average state, local, and district sales and use tax rate consistent with the temporary taxes imposed under the California Constitution and the current statutory definition of “qualified use tax” by deleting the specific reference to “section 35 of” from subdivision (b)(7)(A)’s current reference to the “sales and use taxes imposed under section 35 of article XIII of the California Constitution.” This was because staff determined that deleting the reference to “section 35 of” expands the provisions of subdivision (b)(7)(A) so that they incorporate the rates

of all of the sales and use taxes imposed under article XIII of the California Constitution, which are currently the sales and use taxes imposed by section 35 and the temporary taxes imposed by section 36 of article XIII of the California Constitution. This was also because staff determined that expanding the provisions of subdivision (b)(7)(A) eliminates any future requirements to amend the regulation's definition of the average state, local, and district sales and use tax rate each time a sales and use tax is added to or deleted from article XIII of the California Constitution. The formal issue paper did not recommend that the Board alter the regulation's definition of the average state, local, and district sales and use tax rate in any other way, and did not recommend that the Board make any other changes to the manner in which the Board is required to calculate the estimated amount of use tax due according to a person's AGI.

Board staff submitted Formal Issue Paper 14-008 to the Board for consideration during its November 19, 2014, Business Taxes Committee (BTC) meeting. And, during the Board's November 19, 2014, BTC meeting, the Board Members unanimously voted to propose the amendments to Regulation 1685.5 recommended by staff because the Board determined that the amendments are reasonably necessary for the specific purpose of addressing the issue (or problem) referred to above by including the rate of the temporary taxes in the regulation's definition of the average state, local, and district tax rate.

The Board anticipates that the proposed amendments to Regulation 1685.5 will improve transparency by clarifying that the Board's calculations of the estimated amount of use tax due according to a person's AGI include the rates of all the sales and use taxes imposed under article XIII of the California Constitution. The Board also anticipates that the proposed amendments will benefit the Board by eliminating any future requirements to amend the regulation each time a sales and use tax is added to or deleted from article XIII of the California Constitution.

The proposed amendments to Regulation 1685.5 were not mandated by federal law or regulations. There is no previously adopted or amended federal regulation that is identical to Regulation 1685.5 or the proposed amendments to Regulation 1685.5.

DOCUMENTS RELIED UPON

The Board relied upon Formal Issue Paper 14-008, the exhibits to the formal issue paper, and the comments made during the Board's discussion of the formal issue paper during its November 18, 2014, BTC meeting in deciding to propose the amendments to Regulation 1685.5 described above.

ALTERNATIVES CONSIDERED

The Board considered whether to begin the formal rulemaking process to adopt the proposed amendments to Regulation 1685.5 at this time or, alternatively, whether to take no action at this time. The Board decided to begin the formal rulemaking process to adopt the proposed amendments at this time because the Board determined that the amendments are reasonably necessary for the reasons set forth above.

The Board did not reject any reasonable alternative to the proposed amendments to Regulation 1685.5 that would lessen any adverse impact the proposed action may have on small business or that would be less burdensome and equally effective in achieving the purposes of the proposed action. No reasonable alternative has been identified and brought to the Board's attention that would lessen any adverse impact the proposed action may have on small business, be more effective in carrying out the purposes for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

INFORMATION REQUIRED BY GOVERNMENT CODE SECTION 11346.2, SUBDIVISION (b)(5) AND ECONOMIC IMPACT ASSESSMENT REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

As previously explained, the Board adopted Regulation 1685.5 in 2011 to prescribe the manner in which the Board shall annually calculate the estimated amount of use tax due according to a person's AGI, as required by RTC section 6452.1. And, Regulation 1685.5, subdivision (b)(7), defines the "average state, local, and district sales and use tax rate" for purposes of determining the rate of sales and use tax to be used to calculate the estimated amount of use tax due according to a person's AGI.

Prior to January 1, 2013, the only statewide sales and use taxes imposed under the California Constitution were imposed by section 35 of article XIII and subdivision (b)(7)(A) of Regulation 1685.5 specifically includes the rate of the taxes imposed by "section 35 of article XIII of the California Constitution" in the average state, local, and district sales and use tax rate. However, California voters approved Proposition 30 in the General Election of 2012, Proposition 30 added section 36 to article XIII of the California Constitution to impose temporary sales and use taxes from January 1, 2013, through December 31, 2016, and the rate of the temporary taxes must be included in the Board's calculations of the estimated amount of use tax due according to a person's AGI for 2013 through 2016 to ensure that the Board's calculations are consistent with the provisions of the California Constitution and the statutory definition of "qualified use tax."

The proposed amendments to Regulation 1685.5 update the regulation's definition of the average state, local, and district sales and use tax rate to include the rates of all the sales and use taxes imposed under article XIII of the California Constitution, which are currently the taxes imposed by section 35 and the temporary taxes imposed by section 36 of article XIII of the California Constitution. The current practice of staff in the Board's Research and Statistics Section is to account for all relevant changes to the sales and use tax law, including changes to the California Constitution's sales and use tax provisions, when calculating the estimated amount of use tax due according to a person's AGI. As a result, the Research and Statistics Section's current practice is to include the rate of the temporary taxes in its calculations of the estimated amount of use tax due according to a

person's AGI and, consequently, there is nothing in the proposed amendments to Regulation 1685.5 that would change the way the Board currently calculates the estimated amount of use tax due according to a person's AGI, impact sales and use tax revenue, or impose any costs on individuals and businesses.

The Board anticipates that the proposed amendments to Regulation 1685.5 will improve transparency by clarifying that the Board's calculations of the estimated amount of use tax due according to a person's AGI include the rates of all the sales and use taxes imposed under article XIII of the California Constitution, including the temporary taxes. The Board also anticipates that the proposed amendments will benefit the Board by eliminating any future requirements to amend the regulation each time a sales and use tax is added to or deleted from article XIII of the California Constitution.

Therefore, the Board estimates that the proposed amendments will not have a measurable economic impact on individuals and business. And, the Board has determined that the proposed amendments to Regulation 1685.5 are not a major regulation, as defined in Government Code section 11342.548 and California Code of Regulations, title 1, section 2000, because the Board has estimated that the proposed amendments will not have an economic impact on California business enterprises and individuals in an amount exceeding fifty million dollars (\$50,000,000) during any 12-month period.

Further, based on these facts and all of the information in the rulemaking file, the Board has also determined that the adoption of the proposed amendments to Regulation 1685.5 will neither create nor eliminate jobs in the State of California nor result in the elimination of existing businesses nor create or expand business in the State of California.

Furthermore, Regulation 1685.5 does not regulate the health and welfare of California residents, worker safety, or the state's environment. Therefore, the Board has also determined that the adoption of the proposed amendments to Regulation 1685.5 will not affect the benefits of Regulation 1685.5 to the health and welfare of California residents, worker safety, or the state's environment.

The forgoing information also provides the factual basis for the Board's initial determination that the adoption of the proposed amendments to Regulation 1685.5 will not have a significant adverse economic impact on business.

The proposed amendments to Regulation 1685.5 may affect small businesses.